Overview of the *sukuk* market

Professor Rodney Wilson, *Institute for Middle Eastern and Islamic Studies, University of Durham, United Kingdom*

Modern *sukuk*, sometimes referred to as Islamic bonds, are better described as Islamic investment certificates. This distinction is as crucial as it is important, and it is stressed throughout this pioneering work that *sukuk* should not simply be regarded as a substitute for conventional interest-based securities. The aim is not simply to engineer financial products that mimic fixed-rate bills and bonds and floating-rate notes as understood in the West, but rather to develop innovative types of assets that comply with *Shari'a* Islamic law.

What this means in practice will hopefully become apparent to readers of this book, but it is worth stressing here that the essential concepts are:

- transparency and clarity of rights and obligations;
- that income from securities must be related to the purpose for which the funding is used, and not simply comprise interest; and
- that securities should be backed by real underlying assets, rather than being simply paper derivatives.

Islamic fixed-income securities are already emerging as a significant class of asset, and are as potentially important for the Muslim investor as conventional bonds are for investors generally. In addition, for non-Muslims who already own conventional bonds, the acquisition of *sukuk* introduces a new asset class into their portfolios, bringing further welcome diversity and possibly reducing risk.

The contents

This book is comprehensive in its coverage, and it should provide an indispensable guide

to the options available for those seeking to raise finance through *sukuk* issues or invest in *sukuk* securities. Professional bankers and finance specialists can learn how to structure *sukuk*, and how such securities can be used as tools for asset and liability management. Much attention and space is justifiably given to sovereign *sukuk* as issues by Malaysia, Bahrain and Qatar have attracted widespread international attention from both Islamic and conventional bankers. The scope for converting existing conventional government debt into instruments enjoying *Shari'a* acceptability is clearly enormous, as is the possibility of issuing new debt on potentially cheaper and less risky terms than those applying to conventional bonds.

Although, so far, there have been relatively few corporate *sukuk*, such Islamic securities could become a vital financing tool for companies throughout the Muslim world as well as in the West. The authors devote a whole chapter to this potential as well as to the scope for refinancing housing and commercial *Shari'a*-compliant mortgages through *sukuk* (see Chapter 5). As *sukuk* have to be asset-backed, housing and real estate represent an especially fertile field for such Islamic security issues. Those contemplating launching *sukuk* or investing in such instruments will naturally be concerned with legal and taxation matters. These are discussed in Chapter 6, 'Enabling infrastructure', which addresses the issue of whether some jurisdictions are better than others for *sukuk* issues, as well as how the income from *sukuk* is treated, or may be potentially treated, for taxation purposes.

The legitimacy of *sukuk*

Although there is no compulsion to comply with the rulings of the Fiqh Academy of the Organization of the Islamic Conference, their rulings carry considerable weight with most Islamic financial institutions and their *Shari'a* committees and advisers. At the request of delegates from Jordan, Pakistan and Malaysia, the Fiqh Academy considered the question of Islamic investment certificates at their fourth annual plenary session held in Jeddah in February 1988. They noted that the *Shari'a* encourages the documentation of contracts as stipulated in *sura* 2:282 of the Holy *Qur'an*:

> When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. ...It is more just in the sight of God, more suitable as evidence and more convenient to prevent doubts among yourselves.[1]

Subject to proper legal documentation, the Fiqh Academy, under decision number 5 of 1988, ruled:

- that any collection of assets can be represented in a written note or bond; and
- that this bond or note can be sold at a market price provided that the composition of the group of assets, represented by the security, consists of a majority of physical assets and financial rights, with only a minority being cash and interpersonal debts.[2]

Why have Islamic bonds?

Conventional bonds that yield interest, or *riba*, are of course prohibited under *Shari'a* law. Furthermore, those who buy and sell conventional bonds are rarely interested in what is actually being financed through the bond issue, which could include activities and industries that are deemed *haram* such as the production or sale of alcohol. Companies that are highly leveraged with bank debt may seek refinancing through issuing bonds, but such companies are not regarded as suitable for Muslim investors.

The aim of bond traders usually is to make capital gains as fixed-interest bond prices rise when variable market interest rates fall. Bond trading is therefore largely about exploiting interest rate developments and trading in paper that is usually unrelated to the value of any underlying asset. The major risk for holders of conventional bonds is of payments default, but this risk is usually assessed solely on the basis of credit ratings, with the ratings agency rather than the bond purchaser estimating the risk. Hence the bonds are regarded as mere pieces of paper with third parties estimating the risk and the purchaser, at best, only making a risk/return calculation without any reference to the business being financed.

A number of *Shari'a* scholars, most notably Muhammad Taqi Usmani, have stressed that one of the distinguishing features legitimising Islamic finance is that it must involve the funding of trade in, or the production of, real assets.[3] Merely funding the purchase of financial securities would involve second order financing akin to lending for derivatives, the subsequent gearing being speculative and increasing uncertainty, or *gharar*. Hence, with *murabaha*, commodities are purchased on behalf of a client and resold to the client, the temporary ownership of the commodity justifying the financier's mark-up. *Istisna'a* involves the financing of manufacturing capacity through pre-production payments, but these relate to construction or equipment purchases where real capacity can be identified.

Similarly, *ijarah* involves the leasing of real assets, with the use of the assets justifying the payment of rental to the owner.

As Islamic finance is by nature participatory, purchasers of *sukuk* securities arguably have the right to information on the purposes for which their monies are to be allocated. In other words, the funding raised through Islamic bond issues should be hypothecated or earmarked rather than used for general unspecified purposes, whether by a sovereign or corporate issuer. This implies that identifiable assets should back Islamic bonds.

Salam securities

The concept of *salam* refers to a sale whereby the seller undertakes to supply a specific commodity to the buyer at a future date in return for an advanced price, paid in full on the spot. Hence the price is cash but the supply of the purchased goods is deferred. Muslim farmers used *salam* to receive cash advances in order to meet immediate commitments until their crops were grown as they were not able to borrow on the basis of *riba*. The attraction for the buyer of a *salam* contract is that the advance payment is usually less than the amount that would have to be paid if the buyer deferred his purchase and bought the same commodity spot in one or three months' time.[4]

Salam represents a type of forward contract, but such a contract is forbidden under *Shari'a* law unless there are strict conditions attached that aim at the elimination of uncertainty, or *gharar*. Firstly, the initial payment by the buyer must be paid in full, to ensure there is no uncertainty over outstanding payments. Secondly, *salam* can only be used for commodities that are standardised, and where the quality and quantity are measured exactly. Originally such contracts were used for the purchase of grains such as wheat, barley and rice, but *salam* contracts could also be used for commodities such as oil, iron ore or copper, or indeed even electricity supplies that can be measured in kilowatts.[5] Some authors even suggest that they can be used for the purchase of aircraft seats.[6]

How can certificates based on *salam* contracts be issued? The onus is on the purchaser who can finance the advance payment by issuing certificates that are equivalent to the purchase price, which are then sold. The buyers of the certificates are entitled to the commodities for which the original purchaser contracted at the end of the one or three months, or whatever period was stipulated in the contract. For them the attraction is that they are

purchasing the commodities at a discount, the difference between this and the eventual selling price of the commodities representing their return.

There has been some debate amongst *Shari'a* scholars about whether it is legitimate to exchange the rights to commodities sold on a *salam* basis prior to delivery or, in other words, to trade *salam* certificates. Ibn Taimiyah (1263–1328), the distinguished Muslim scholar, ruled that such exchanges are permissible as long as when the certificates were sold to the seller it was not for a price higher than that agreed originally, as this might be seen as exploitation.[7] Sales to third parties could be at any price that such buyers are willing to pay. The Maliki School of Islamic jurisprudence stipulated that *salam* contracts relating to foodstuffs should not be traded, as this could be interpreted as speculating on necessities. Sami Homoud states that it is not permissible to resell the commodity covered by a *salam* contract before receiving it, but this does not preclude the recipient from reselling the commodity by another contract parallel to the first one.[8] The aim of such a parallel or back-to-back *salam* contract is to ensure that the financier, usually a bank, is not left with a commodity that it has no expertise in trading.[9] However, creating *salam* certificates could also be viewed as a way out of this dilemma for a bank.

Ijarah bonds

Under an *ijarah* contract, the usufruct of a particular property is transferred from the owner to another person in exchange for a rental payment. In other words, it is a leasing agreement with the lessor refereed to as the *mujir*, the lessee called the *mustajir* and the rent paid to the lessor called *ujrah*. *Shari'a* law imposes restrictions on *ijarah* agreements that are not present in conventional leasing contracts, largely to protect the parties as far as possible from uncertainty and to ensure there is no ambiguity in the agreement.

In particular the duty to repair and maintain the property being leased remains with the lessor as owner as if the lessee was liable this would introduce an additional element of uncertainty with respect to the costs to the lessee as maintenance payments could be regarded as an extra rental element.[10] Expenses related to the operation of a leased asset are, however, the responsibility of the lessee, such as fuel in the case of a leased vehicle or aircraft, or fertiliser and seeds in the case of leased land. Where a leased asset is accidentally destroyed or its usufruct value reduced, as in the case of leased farmland during periods of prolonged drought, then *ijarah* contracts can be cancelled by the lessee, but in modern practice leased assets usually are insured against such contingencies.

If lessees are negligent in using the asset, which results in a reduction or the complete destruction of its value, they may be liable to compensate the owner. In practice *ijarah* leasing agreements have many clauses that are similar to conventional leasing arrangements. Where payments are late, the lessor cannot impose a penalty, as any gain from this would represent an additional burden for the lessee and a gain for the owner that would be comparable to *riba*. The lessee may be obliged to donate an amount to charity however, as recognition that there has been a delay in the rental payment. If no payment is made, then use of the leased asset will revert to the owner, and the lessee may still be liable for the rental payments stipulated in the original contract.

As an *ijarah* contract is for a predetermined period, and as the rent provides a regular monthly, quarterly or annual income, it is clearly well suited to be covered by the issue of securities that have many of the characteristics of bonds. As *ijarah* bonds are securities representing the ownership of well-defined assets subject to a lease contract, they may be traded in a secondary market at the prevailing price determined by market forces. There can be many issuers of *ijarah* securities, including ministries of finance, central banks, municipalities, authorities responsible for *waqf* or religious endowments, investment banks, or public or private companies. Such securities have maturity periods of five years or more, although at present there are few issues running for more than 10 years.

It is important to note that *ijarah* certificates or securities represent a proportionate ownership claim over a leased asset, and therefore those who hold the securities have ownership responsibilities that only terminate when the securities mature, or if they are sold to another party who then assumes the responsibilities.[11] Unlike shareholders in the equity of a joint stock company, however, whose ownership rights are in perpetuity, those of the holder of an *ijarah* certificate are for a fixed period. Furthermore holders of *ijarah* certificates only benefit from monthly, quarterly or annual rental payments as they cannot enjoy capital gains that are usually the main motivation for equity investments. On the other hand, investment in *ijarah* certificates is less risky than equities, and the income stream is for a fixed regular amount, whereas any dividends accruing to equity investors can be subject to considerable variation.

Istisna'a bonds

Project financing can be undertaken through an *istisna'a* contract, whereby funds are advanced to pay for the supplies and labour costs by an Islamic bank. Once the project is

completed, the advances are repaid from the revenue derived from the project. Originally, *istisna'a* was seen as an appropriate way of financing manufacturing as goods have to be produced and costs incurred before they are sold.

To introduce bonds based on *istisna'a* a parallel *istisna'a* contract is generally used whereby the financier enters a contract with a subcontractor who actually builds the facility being financed. To use *istisna'a*, the public authority or private company commissioning the project provides details of the specifications and timing of the schemes. The financier then sets these out in the tender documents. Bids are subsequently invited from contractors who will specify how they intend to sell completed parts of the project over time and the amount of each payment instalment expected. These instalments will include an element of profit over the construction costs. As the financier is expecting a stream of payments over a specified period, certificates can be issued based on the income expected.

It should be noted that as the deferred price certificates represent debt obligations they cannot be traded for cash at below face value in a secondary market. They can, however, be used to purchase goods or services whose price is equal to the face value of the certificate. The purchase price of the goods may be less than the deferred price as this represents a trading transaction. Permission to transfer the debt contract from the financier to a supplier of goods and services must be sought from the original debtor, the public authority or private company commissioning the project.[12]

Potential for *mudaraba* and *musharaka* bonds

There is also scope for introducing *mudaraba* and *musharaka* bonds, although arguably these should be designated as notes as the returns will be variable rather than fixed, as is the case with *salam*, *ijarah* and *istisna'a* certificates. *Mudaraba* has been most successful in the case of investment deposits with an Islamic bank where the return is calculated annually based on the bank's profits. Certificates of deposit based on these *mudaraba* deposits could be issued and traded, although this has not happened so far.

It should be noted that holders of *mudaraba* notes do not enjoy the same rights and benefits as equity investors as they are only entitled to a profit share and there is no provision for capital gains based on the market valuation of the company. The *mudaraba* note holders are not registered owners, and cannot attend or vote at the annual general meeting. On the other hand, although the value of their notes cannot be guaranteed, it is the

shareholders rather than *mudaraba* note holders who are more likely to suffer from capital losses in the event of the company performing badly. In the case of bankruptcy the note holders will be in a higher position in the pecking order than equity investors, who are likely to lose all of their money.

Mudaraba certificates were first issued in Pakistan under an ordinance passed in 1980, with companies with a paid-up capital of at least PRs5 million allowed to offer such certificates to the public.[13] These enjoyed some limited success but the returns were disappointing, partly reflecting the weakness of the companies involved and, more generally, the poor performance of Pakistan's economy. The Jordanian Ministry of *Waqf* has issued *mudaraba* bonds, although there was some controversy concerning the guarantee of capital on maturity, and the Islamic Fiqh Academy recommended that this should be a voluntary commitment, referred to as *tabarru*, rather than an absolute guarantee. Conventional banks in Egypt, notably Bank Misr, have also issued *mudaraba* certificates as one of their Islamic products, but there has been some concern about possible co-mingling of funds and the guarantees of the bond principal, which violate the *Shari'a* principle of no reward without risk or effort.

Musharaka involves establishing a partnership or company to provide financing with the participants sharing in the profits in relationship to the size of their investment share. Notes can be issued on the basis of such financing and both Sudan and Iran have launched such securities.[14] In practice these have been very similar to *mudaraba* certificates rather than being a distinct asset class. Clearly there is much scope for product development in this area, with the rights and privileges of *musharaka* certificate holders better defined in relation to those of equity investors and *mudaraba* certificate holders.

The Malaysian *sukuk* experience

One of the attractions of conventional bills and bonds is that they are used as liquidity management tools, but Islamic banks cannot, of course, hold such *riba* instruments.[15] The first attempt to overcome the liquidity problem facing Islamic banks was undertaken by Bank Negara Malaysia (the Central Bank) in July 1983, after the first Islamic bank in Malaysia began operations, as it was realised that Bank Islam Malaysia could not hold government securities or Treasury bills that paid interest. Therefore, non-interest-bearing paper was issued, namely, Government Investment Certificates and Government Investment Issues. Bank Islam Malaysia could acquire these certificates, which represented a beneficial loan (*qard hassan*) to the government. There was no pre-determined rate of interest on these

securities, rather the rate of return would be declared by the government at its 'absolute discretion'. A dividend committee, comprising representatives of the Ministry of Finance, Bank Negara, the Economic Planning Unit and the Religious Affairs Section of the Prime Minister's Office, was established to regularly declare the rates. There was no fixed formula for determining the rate of return, the stress being on qualitative rather than purely quantitative considerations. Those setting the return considered a range of indicators including macroeconomic conditions, the inflation rate and the yield for similar instruments.

Following the decision in Malaysia to allow conventional banks to accept Islamic deposits and offer Islamic financing facilities, Bank Negara recognised that these developments would be helped if an inter-bank money market could be established. On 18 December 1993, guidelines were therefore issued on how a new Islamic inter-bank money market would operate. The market was opened on 3 January 1994 in Kuala Lumpur, its main functions being to facilitate inter-bank trading of Islamic financial instruments, notably *mudaraba* interbank investments (MII). The MII scheme provides a mechanism whereby a deficit Islamic banking institution (the investee bank) can obtain funds from a surplus Islamic financial institution (the investor bank) by issuing a *mudaraba* certificate for a fixed period of investment ranging from overnight to 12 months.[16]

The investor bank in the MII scheme does not know in advance what the actual profit will be as it depends on the gross profit of the investee bank. The profit-sharing ratio is, however, agreed in advance and the principal is repaid at the end of the loan period. To increase certainty further, Bank Negara introduced a minimum benchmark rate on 2 February 1996, which is the prevailing rate on Malaysian government investment issues plus a spread of 0.5 percent. Investee banks are not obliged to declare profit shares based on this benchmark, but it is a guide to investor banks to the sort of return they can reasonably expect and therefore can be taken into account in the negotiations on the profit-sharing ratio.

Cagamas Berhad, the National Mortgage Corporation of Malaysia, introduced a new scheme for the purchase of Islamic higher purchase debts in December 2001.[17] This scheme, and the launch of Islamic mutual funds based on *sukuk* investments by RHB Bank, illustrates how innovative Malaysia is in launching new Islamic financial products.

Bahrain's sovereign *sukuks*

On 13 June 2001, the Bahrain Monetary Agency offered, for the first time in the Gulf,

government bills that were structured to comply with *Shari'a* Islamic law.[18] The bills were worth US$25 million, and were in the form of three-month paper, referred to as *sukuk salam* securities. Although the Malaysian government has offered Islamic bonds since the 1980s, as already indicated, some governments in the Arab world have been forced to borrow in international markets rather than locally because of Islamic objections to trading in debt and interest-based securities. Governments have issued paper that the local commercial banks have held to maturity, but not traded. This, however, restricts the liquidity of bank assets and makes it more difficult for the government to raise finance directly from the public.

With its new *sukuk salam* securities, Bahrain has overcome this problem by providing a fixed return, equivalent to 3.95 per cent at an annualised rate, for the first Islamic bill issue which is not based on interest. The return has been calculated in relation to the real benefit the government expects to obtain on the funds, rather than with reference to market interest rates. The first securities matured on 12 September 2001 and a new issue was launched, a process that has been repeated every three months.

The establishment of the Islamic money market in Bahrain will, it is hoped, result in the emergence of markets in longer-term Islamic securities, notably bonds, with Bahrain playing a similar role in the Gulf and west Asia to that of Kuala Lumpur in South-east Asia. The initial offer of bills in June 2001, worth US$25 billion, was oversubscribed with almost US$60 million being offered. The minimum subscription was fixed at US$10,000, which meant that relatively small financing houses could participate as well as private investors seeking a non-banking home for their dollar-denominated liquidity. The same minimum subscription limit was set for the longer-term *ijarah* leasing securities, worth US$100 million, that were offered in August 2001. These were issued on 4 September 2001 and will mature in 2006. They offer a rental return of 5.25 per cent per annum guaranteed by the government of Bahrain. By October 2003, the total *sukuk* portfolio managed from Bahrain exceeded US$1 billion and prospects for the years ahead look very encouraging.[19]

In February 2002 in Bahrain, an Islamic Liquidity Management Centre was established, with the Kuwait Finance House, the Dubai Islamic Bank and the Bahrain Islamic Bank each subscribing US$5 million for the centre. *Shari'a*-compliant assets are purchased through the centre from governments, financial institutions and companies and then pooled. *Sukuk* securities are then issued based on the value of the underlying assets and can then be traded.

Case study: Qatar Global *Sukuk*

As the Qatar Global *Sukuk* valued at US$700 million and offered on 8 October 2003 was the largest such issue to date, it is interesting to examine it as a case study.[20] The certificates issued are redeemable in 2010; hence, the period for the issue is seven years. Distributions to *sukuk* holders are made twice annually on 9 April and October or the immediate business day thereafter commencing April 2004. The certificates were issued in minimum denominations of US$10,000 and integral multiples of US$1,000 in excess thereof. The joint lead managers for the issue were HSBC Bank and the Qatar International Islamic Bank, with the co-managers being the Abu Dhabi Islamic Bank, Gulf International Bank, Kuwait Finance House, Commerce International Merchant Bankers of Malaysia, the Islamic Development Bank and the Qatar Islamic Bank.

The registered issuer is the Qatar Global *Sukuk*, a joint stock company incorporated in Qatar under article 68 of the Commercial Companies Law Number 5 of 2002. The issuer was incorporated solely for the purpose of being involved in the *sukuk*. The nominal authorised and issued capital of the issuer is QR30 divided into three ordinary shares of QR10 each. The government of Qatar as seller delivered to the issuer a parcel of land, which it in turn leased back for seven years, after which ownership reverts to the government. Payments are made under a master *ijarah* agreement, with HSBC Bank acting as payments administrator.

Returns to holders of the certificates are variable, and calculated on the basis of the London inter-bank offer rate (Libor) on dollar funds plus 0.4 per cent per annum, which makes the certificates competitive with, and similar to, conventional floating-rate notes. This provision can be criticised, but it should be noted that Libor is only used as a benchmark and the returns themselves do not represent interest payments, but rather rents related to a real underlying asset – the leased parcel of land supplied by the government of Qatar. It would nevertheless be desirable in the longer term if alternative benchmarks to Libor were identified, particularly if returns were calculated in relation to the profitability of the projects being financed by the *sukuk*. In the case of sovereign *sukuk*, macroeconomic indicators such as real GDP growth could be used, or non-oil GDP growth in the case of states such as Qatar, to avoid the returns being subject to direct oil pricing risks.

Scope for sovereign *sukuk* in Saudi Arabia

The Saudi market in government bills and bonds has become much more sophisticated in recent years, partly reflecting the growth of government debt and the consequent efforts

to find more methods of funding it. The Kingdom has been increasingly innovative in its funding, with a growing use of very short-term repurchase agreements (repos). These are short-term loans in which Treasury bills serve as collateral or the asset the lender receives if the borrower does not pay back the loan. The Saudi Arabian Monetary Agency (SAMA) handles these through its transactions with the commercial banks, with the repos serving as their liquid assets. The average value of repos was SR1.8 billion and reverse repos SR3.2 billion in 2002, compared with averages of SR1.6 and SR1.0 billion respectively in 2000.[21]

Saudi Arabia's commercial banks finance a large part of the government's debt, with almost SR100 billion outstanding. Development bonds account for most of this debt, bank claims on public sector enterprises, which amount to only SR10 billion, being less significant. Internal borrowing has enabled the Saudi Arabian government to be less reliant on international credit to cover budget deficits. As a result of the policy of securing government funding on a longer-term basis, there has been a shift from bills to development bonds, the latter having increased significantly, reflecting government budgetary deficits. Despite their name, development bonds can be used to fund government current expenditures and are not earmarked for longer-term development projects. Yields move in line with those on Eurodollar bonds, reflecting the fixed exchange rate between the riyal and the dollar. Falling interest rates since 2000 have decreased bond yields, although the gap has widened between bill yields that reflect short-term interest rate movements and bond yields that respond to longer-term expectations that influence bond prices.

There is an increasing variety of government development bonds on offer as SAMA has tried to offer terms that the market finds attractive. Two-, three-, four- and five-year development bonds were offered until 1997, when four-year issues matured and were no longer offered. In 1999, 10-year bonds were introduced for the first time and in 2001 seven-year bonds were launched.[22] The development bonds are issued in denominations of SR1 million to wholesale investors and SR50,000, or multiples thereof, to retail investors. In practice, the local banks largely hold these bonds. The bonds are linked to SAMA's repo facility, with the banks allowed to raise liquidity up to the value of 75 per cent of their gross bond holdings at the nominal value of the issues, with repos running from overnight to 28 days.

Given the widening range of debt instruments in Saudi Arabia, it would be a natural progression to introduce Islamic bills and bonds to develop the financial markets further and extend investors' choices. The establishment of the new Capital Markets Authority in 2004 presents an opportunity for Saudi Arabia to play a more pro-active role in launching

sukuk.[23] Islamic securities would mean that dedicated Islamic institutions such as the Al Rajhi Banking and Investment Corporation would be able to hold government paper. This would facilitate their liquidity management. As other institutions, such as Al Jazira Bank, convert their operations to ensure *Shari'a*-compliance, they would also be in the market for such securities. Furthermore, as the major institutions such as the National Commercial Bank increase their *Shari'a*-compliant liabilities by accepting Islamic deposits, there is a need for corresponding liquid assets such as Islamic bills and bonds.

Potential for corporate *sukuk*

Once a market in sovereign *sukuk* is established, there should be more scope to develop corporate *sukuk*, with the Saudi Arabia Basic Industries Corporation (SABIC) or Saudi Telecom being possible beneficiaries. As Saudi Arabia embarks on gas projects worth SR80 billion over the next 10 years, the scope for corporate bond financing is considerable. The Islamic Development Bank has agreed to set up an international Islamic Rating Agency that will be located in Bahrain. Corporate and sovereign *sukuk* could be rated by this agency, and a Gulf Cooperation Council- (GCC-) wide market created in which Islamic securities could be traded, with Saudi Arabia playing the leading role.

Saudi Arabia's first corporate *sukuk* was issued in 2004 on behalf of HANCO Rent-A-Car, one of the Kingdom's leading car leasing and rental companies. The product, named the Caravan *Sukuk*, runs for three years with a variable rate of return paid to investors on a monthly basis, which is forecast to be 6 per cent per annum. The *sukuk*, which was structured on an *ijarah* basis, was approved by Yasaar Limited, the provider of *Shari'a* advisory services, and managed by Volaw Trust and Corporate Services, a Jersey-based law firm with extensive contacts in the Gulf.[24] This *sukuk* was followed closely by a similar offering, designated Tabreed, on behalf of the National Central Cooling Company, which raised US$100 million, with the *sukuk* structured using a combination of *ijarah* and *istisna'a*. The lead managers were the International Investor of Kuwait and Credit Suisse First Boston.[25]

Noriba Bank, the Bahrain-based Islamic finance subsidiary of the Swiss UBS Group, envisages becoming a significant player in the corporate *sukuk* market. Rival Citigroup's Islamic finance subsidiary, Bahrain-based Citi Islamic Investment Bank, has already managed the *sukuk* offered by the Jeddah-based Islamic Development Bank in 2003 that raised US$400 million through a structure predominately based on *ijarah* assets, but also including *murabaha* and *istisna'a* contracts.[26]

These developments highlight the rapidly developing interest in *sukuk*, which demonstrates how timely this book is. It is likely to be *sukuk* issues, rather than simply the growth of Islamic bank assets, that will account for most of the development in the Islamic finance industry in the coming decade.

---

[1] *The Holy Qur'an*, text, translation and commentary by Abdullah Yusuf Ali (Kuwait: That Es-Salasil Printing and Publishing, reprint in 1988 of 1934 1st edition).

[2] Kahf, Monzer, 'The use of *ijara* bonds for bridging the budget gap', *Islamic Financial Instruments for Public Resource Mobilisation*, Ahmad, Ausaf, and Tariqullah Khan (eds) (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Seminar Proceedings Number 39, 1997), p. 293.

[3] Usmai, Muhammad Taqi, *An Introduction to Islamic Finance* (The Hague: Kluwer Law International, 2002), pp. xiv–xvii.

[4] Vogel, Frank, and Samuel Hayes, *Islamic Law and Finance: Religion, Risk and Return* (The Hague: Kluwer Law International, 1998), p. 77.

[5] Elgari, Mohammad Ali, 'A short term financial instrument based on the *salam* contract', *Islamic Financial Instruments for Public Resource Mobilisation*, Ahmad, Ausaf, and Tariqullah Khan (eds) (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Seminar Proceedings Number 39, 1997), p. 252.

[6] Muhammad al-Amine, Muhammad al-Bashir, 'The Islamic bonds market: possibilities and challenges', *International Journal of Islamic Financial Services* (Volume 3, Number 1, 2001), pp. 1–18.

[7] For a discussion of the thinking and rulings of Ibn Taimiyah on prices and markets see Islahi, Abdul Azim, *Economic Concepts of Ibn Taimiyah* (Leicester: The Islamic Foundation, 1988), pp. 75–102.

[8] Homoud, Sami, 'Islamic financial instruments based on intermediary contracts', *Islamic Financial Instruments for Public Resource Mobilisation*, Ahmad, Ausaf, and Tariqullah Khan (eds) (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Seminar Proceedings Number 39, 1997), p. 223.

[9] Vogel, Frank, and Samuel Hayes, *Islamic Law and Finance: Religion, Risk and Return* (The Hague: Kluwer Law International, 1998), p. 146.

[10] Kafh, Monzer, 'The use of *ijara* bonds for bridging the budget gap', *Islamic Financial Instruments for Public Resource Mobilisation*, Ahmad, Ausaf, and Tariqullah Khan (eds) (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Seminar Proceedings Number 39, 1997), p. 291.

[11] Usmani, Muhammad Taqi, *An Introduction to Islamic Finance* (The Hague: Kluwer Law International, 2002), pp. 80–81.

[12] Muhammad al-Amine, Muhammad al-Bashir, 'The Islamic bonds market: possibilities and challenges', *International Journal of Islamic Financial Services* (Volume 3, Number 1, 2001), pp. 1–18.

[13] Gieraths, Christine, 'Pakistan: main participants and financial products of the Islamisation process', *Islamic Financial Markets*, Wilson, Rodney (ed.) (London: Routledge, 1990), pp. 171–195.

[14] Yasseri, Ali, 'The experiences of the Islamic Republic of Iran in *musharakah* financing', *Arab Law Quarterly* (1999), pp. 231–244.

[15] Ahmed, Osman Babikir, *Islamic Financial Instruments to Manage Short-Term Liquidity*, (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Research Paper 41, 1997), pp. 19–40.

[16] Ahmad, Ausaf, *Towards an Islamic Financial Market: A Study of Islamic Banking and Finance in Malaysia*, (Jeddah: Islamic Research and Training Institute, Islamic Development Bank, Research Paper 45, 1997), pp. 46–58.

[17] www.cagamas.com.my, accessed 20 April 2004.

[18] Bahrain Monetary Agency, *Islamic Banking and Finance in the Kingdom of Bahrain* (Manama: 2002), pp. 72–78.

[19] 'Billion dollar *sukuk* portfolio for Bahrain', *Islamic Banking Hub Quarterly Newsletter* (Manama: Islamic Banking and *Takaful* Taskforce, October 2003), p. 1.

[20] Documented on the published terms of the Qatar Global *Sukuk*, QSC, circular of 8 October 2003.

[21] Data supplied by the Saudi Arabian Monetary Agency (Riyadh: December 2003).

[22] Dew, Philip, *Saudi Arabia: Restructuring for Growth* (London: Euromoney Books, 2003), pp. 71–72.

[23] Wilson, Rodney, *Economic Development in Saudi Arabia* (London: RoutledgeCurzon, 2004), p. 70.

[24] Information provided by Trevor Norman of Volaw Limited, a contributor to *Islamic Asset Management: Forming the Future for Shari'a-Compliant Investment Strategies* (London: Euromoney Books, 2004).

[25] 'Capital market news', *TradeArabia*, (Manama: 12 April 2004).

[26] Cole, Margaret, and Mohammed Al-Sheikh, 'The Growth of *Sukuk* in the Global Capital Markets', *AsiaLaw* (Singapore: 2 February 2004).